

Report on the Failure of Jefferson Bank & Trust (A9307)

Jefferson Bank & Trust (JBT), a state member bank in Lakewood, Colorado, was closed by the Colorado State Bank Commissioner on July 2, 1993. The bank's failure will result in an estimated \$41 million loss to the FDIC's bank insurance fund. As required by FDICIA, we reviewed the Federal Reserve's supervision of JBT to (1) ascertain why the institution's problems resulted in a material loss to the insurance fund and (2) make recommendations for preventing any such loss in the future.

JBT failed as a result of fraud committed by the bank's investment advisor. However, JBT's failure to establish adequate controls over its trading account assets allowed the fraud to occur and remain undetected, even though the collusive nature of the fraud may have circumvented even proper controls. We concluded that the level of supervisory actions taken was appropriate for the problems identified by the examiners, specifically asset quality, trading policy issues, and capital adequacy. However, we believe that a more thorough review of the bank's internal controls would have uncovered the weak controls over investment and trading activities. In addition, we believe the examiners failed to apply the Board's supervisory policy standards with regard to the concentration of securities held with the selling broker-dealer. We also believe that off-site monitoring personnel should have followed up on the bank's trading activity sooner.

Our report contains four recommendations to the Board to improve supervisory guidance for use of investment advisors by state member banks, strengthen controls over the examination of banks' investment and trading activities, update the *Commercial Bank Examination Manual*, and strengthen workpaper retention standards. Because of the apparent collusion involved, however, there is no guarantee that the fraud would have been uncovered even if our recommendations had been in place prior to JBT's failure. The responsible director characterized the report as positive even though he took issue with the way some matters were presented. In general, he agreed with our conclusions on the level of supervision and the reason for the failure, and with most of our recommendations.